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CITATIONS

93247—38——1

In the Supreme Court of the United States

OCTOBER TERM, 1938

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

R. J. REYNOLDS TOBACCO COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in the above-entitled cause on June 6, 1938, reversing a decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 21) is reported in 35 B. T. A. 949. The opinion of the Circuit Court of Appeals (R. 108) is reported in 97 F. (2d) 302.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 6, 1938 (R. 116). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

After the taxpayer, a corporation, had originally issued its stock, it traded in its own stock on the open market, buying for cash and selling for cash, without any intention or authority to increase or decrease its authorized capital. During 1929, the taxable year, the taxpayer derived a gain from such trading in its own stock. However, the applicable Treasury regulations, Article 66 of Treasury Regulations 74, provided in part that a corporation realizes no gain or loss from the purchase or sale of its own stock. Subsequently the applicable Treasury regulations were amended by Treasury Decision 4430 to provide that where a corporation deals in its own stock as it might in the shares of another corporation the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. The question presented is whether this case is properly governed by the rule set forth in the original or in the amended regulation.

STATUTE AND OTHER AUTHORITIES INVOLVED

The statute and other authorities involved will be found in the Appendix, *infra*, pp. 26–29.

STATEMENT

The facts, as found by the Board of Tax Appeals (R. 22–30), are substantially as follows:

The taxpayer is a corporation organized in 1899 under the laws of the State of New Jersey. Its principal office and place of business is Winston-Salem, North Carolina. It is engaged in the manufacture and sale of tobacco products, including plug, twist, smoking tobacco, and cigarettes (R. 22).

From time to time since 1901 the capital structure of the corporation has been changed by increases in the common stock by the issuance of new classes of common stock known as class B common, later eliminated in favor of new class B common; by the issuance and subsequent retirement of preferred stock; by stock dividends; and by stock split-ups due to reduction in the par value of the common stock (R. 22–23). During the taxable year 1929 the total capitalization of R. J. Reynolds Tobacco Company was (R. 23):

1,000,000 shares common stock at $10 par value	$10,000,000
9,000,000 shares new class B common stock at $10 par value	90,000,000
10,000,000 shares outstanding capital stock	100,000,000

The principal difference between common stock and new class B common is that the latter had no voting power and was not considered under the company's plan providing for participation by officers and employees in certain profits of the company. There was no authorization during the tax-

able year by charter amendment whereby the authorized number, class, or par value of taxpayer's shares of stock was increased or decreased (R. 23).

In 1912 the taxpayer was young in the tobacco industry, being a very small corporation whose stock was owned by one family until other stockholders were brought in from time to time. Its principal stockholder and founder was R. J. Reynolds, whose practice it was to bring as many employees as possible into the company as stockholders. Under the by-laws of the company the holders of the only stock then outstanding were entitled to a special distribution each year based on the profits realized, and as a result the owners of this class of stock retained their holdings in order to participate in the profits (R. 23).

At 1912 taxpayer was in vigorous competition with three other tobacco companies, each having many times the capital of taxpayer. After 1912 taxpayer's growth was rapid. Its business prospered to such an extent that maintaining the capitalization of the company at a point where it could support the rapid expansion of the business, and meet competitive conditions, presented a serious problem. At the same time the management of the taxpayer desired to preserve (1) the reputation of the company, (2) the reputation of the stock, and (3) the behavior of the stock on the market, including its behavior in comparison with other similar stocks (R. 23).

In 1918 the taxpayer created the class B common stock which did not participate in the special dis-

tribution based on the company's profits, and which was, therefore, available on the open market. Later this class B stock was eliminated by charter amendment in April 1926 (R. 23–24).

In July 1918 R. J. Reynolds, taxpayer's largest stockholder, died. It became necessary for his estate to sell a substantial portion of the stock in order to pay the inheritance taxes on his estate. This stock was purchased by several individuals, but subsequently and prior to 1921 it was finally concentrated in the single ownership of United Retail Stores, which controlled United Cigar Stores Company, a large distributor of taxpayer's tobacco products. United Retail Stores publicized the fact that it owned a substantial block of taxpayer's stock. Rumors developed and the suspicion grew that United Retail Stores was dictating taxpayer's business policies and was able to buy taxpayer's tobacco products at lower prices and for better discount than other distributors and retailers. Furthermore, the dividends regularly paid by the taxpayer made it possible for United Retail Stores to operate its approximately 2,000 retail stores without profit, and yet have a substantial amount with which to pay dividends to its own stockholders (R. 24).

It was the judgment of taxpayer's management that the reputation of the company and the necessity of protecting its business required the purchase of this United Retail Stores stock. Taxpayer had recognized in 1918 the necessity of broad-

ening its stockholding base, and the acquisition of this block of stock afforded taxpayer an opportunity to remove a harmful situation and at the same time permitted taxpayer to expand its stockholding list by feeding the stock back onto the market. The law department of the taxpayer considered and ruled that taxpayer was authorized to make the 1921 purchase, and the other purchases hereinafter related, and reissue the stock, although taxpayer had no charter authority to deal in its own stocks (R. 24).

For the reasons aforementioned the taxpayer purchased during 1921 the block of old class B common stock held by United Retail Stores, the number of shares purchased being undisclosed. The purchase was made at a private sale, the stock in question not being listed on any exchange in 1921. The consideration paid was $607,200.96 in cash, which was slightly under the market price by reason of the amount of stock involved. As a result of subsequently effected stock split-ups and stock dividends that portion of this purchase here involved came to represent 75,000 shares of new class B common stock, the certificates therefor being held by taxpayer on January 31, 1929 (R. 24–25).

During all the years 1921 to 1929, inclusive, and thereafter, the taxpayer followed the same general policy of availing itself of all opportunities that were presented for extending its stockholding base. The effectiveness of this general policy is revealed by the increase in the number of taxpayer's stock-

holders over a period of years. In March 1922, when taxpayer's stock was listed on the New York Stock Exchange, taxpayer had less than 2,000 stockholders, counting common stock and class B common stock. At the time of the market crash in 1929 there were 9,136 shareholders of B stock alone. In 1933 there were 41,000 stockholders and in April 1936 there were 52,000 holders of B stock (R. 25).

In 1924 taxpayer sold for cash 21,067 shares of the stock purchased in 1921 from United Retail Stores. The sales were made in the second and third quarters of 1924 on a rising market, following a substantial drop of the market in the first quarter (R. 25).

In 1925 the taxpayer sold for cash 11,000 shares of the stock purchased in 1921 from United Retail Stores. These shares were sold or reissued between February 10 and August 13, 1925. The management took advantage of a rising market to dispose of these shares without hurting its stock or the reputation of the taxpayer (R. 25).

By reason of a charter amendment in 1926 the management of taxpayer feared that speculators on the market might start a rumor that taxpayer would declare a stock dividend. To protect the reputation of the stock, which included keeping it from jumping and precipitately dropping, the taxpayer purchased through a broker for cash 21,400 shares of its stock. After fear of the rumor had passed the 21,400 shares were gradually fed back into the market (R. 25).

In 1927 the taxpayer's only transaction respecting its own stocks was the disposition of certain fractional shares accumulated in its hands in connection with the issuance of rights to subscribe or receive additional stock. These fractional shares, which had cost taxpayer nothing, were disposed of for cash in the amount of $240.83 (R. 25–26).

During April 1928 taxpayer reduced the [illegible] of its cigarettes from $6.40 to $6 per tho[illegible] Following this reduction the volume of taxpay[illegible]s stock offered on the market was greatly multiplied. Taxpayer, with a view to protecting the reputation of the stock of the company, its business, and its brands, purchased for cash 43,300 shares of its stock, expecting thereby to protect the market against a precipate fall in prices. After the market steadied the 43,300 shares were fed back into the market, together with 1,240 shares of the stock acquired from United Retail Stores in 1921 (R. 26).

During each of the aforesaid years 1924 to 1928, inclusive, the taxpayer, R. J. Reynolds Tobacco Company, reissued solely for cash certain shares of its new class B common stock, theretofore acquired solely for cash, in a manner similar to that hereinafter set forth with respect to the taxable year 1929. Such transactions were made under circumstances and for reasons substantially similar to those surrounding the said similar transactions in the year 1929. For the purpose only of showing generally the result of such transactions during each of said years 1924 to 1928, inclusive,

and for no other purpose, the parties below agreed that, in executing its income tax return for each of such prior years, the taxpayer noted in "Schedule L—Reconciliation of Net Income and Analysis of Change in Surplus" and under subtitle (of said schedule L) entitled "2. Non-taxable income * * * (f) Other Items of Non-Taxable Income (to be detailed)" under the notation "Profit R. J. R. Stock", or substantially similar notation, the following amounts (R. 26):

Years	*Amounts*
1924	$999,335.25
1925	601,507.42
1926	85,003.70
1927	240.83
1928	1,271,023.19

At the close of 1928 taxpayer had 30,000 shares of its new class B common stock, which became 75,000 shares by January 31, 1929, due to a 2½ for 1 split-up approved by the stockholders on December 28, 1928, thus reducing the par value of the stock from $25 per share to $10 per share (R. 26–27).

Subsequent to January 31, 1929, the taxpayer canceled certificates representing 15,000 shares of said 75,000 shares and issued in lieu thereof new certificates representing 15,000 shares of new class B common stock to divers persons who delivered to taxpayer the sum of $708,690 in cash for said 15,000 shares. The 15,000 shares so disposed of by taxpayer were acquired as a part of taxpayer's 1921 purchase at a cost to taxpayer of $121,440.19 in cash (R. 27).

On December 18, 1929, 2,106,139 shares, or more than 23 percent of the total outstanding 9,000,000 shares of taxpayer's new class B common stock, were in the hands of brokers, subject to trading or speculation. This stock was in a position to do great injury to taxpayer, its stock, and its products. Approximately 2,000 employees of taxpayer held shares of its stock and many of them had borrowed heavily on their stock. With the then market price of approximately 64, a heavy drop in the market would have been disastrous to many of taxpayer's employees (R. 27).

At the time of the market break in 1929 taxpayer had $29,000,000 in cash and Government securities, which the management determined to and did use in purchasing the taxpayer's stock offered on the market during the break in October and November 1929. During the height of the stock market panic, from approximately October 29 to November 13, 1929, taxpayer held the market price of its stock at 50, purchasing 90 per cent of its stock offered on the market. As the panic eased, taxpayer's purchases were scaled down to 40 and 39. During the taxable year 1929 taxpayer purchased a total of 574,880 shares of its own stock (R. 27).

In addition to selling the 15,000 shares aforementioned during 1929, taxpayer sold 194,000 other shares of the new class B common stock it had purchased in 1929. One block representing 94,500 shares of new class B common stock was acquired by taxpayer for cash in the amount of $4,908,966.17. Later in 1929 taxpayer canceled the

certificates representing these 94,500 shares, issuing new class B common stock certificates in lieu thereof to divers persons for $4,506,497 in cash. Another block of 99,500 shares of new class B common stock was acquired by taxpayer in 1929 for $4,601,807.43 in cash. Later in 1929 taxpayer canceled the certificates representing these 99,500 shares, issuing new class B common stock certificates in lieu thereof to divers persons for $4,703,608 in cash. The transactions covering the said 94,500 and 99,500 share blocks of stock were handled by brokers on the New York Stock Exchange (R. 27–28).

At all times during 1929 the stock books and records of the taxpayer indicated that the number of its new class B common stock issued and outstanding was 9,000,000 shares. From the time of acquisition of the certificates representing shares of taxpayer's stock until the time of their cancellation and the issuance of new certificates in lieu thereof, the said certificates were regularly entered and recorded on the balance sheets in the financial statement of taxpayer under the entry "Investments in Non-competitive Companies", in which all of such stock was entered and carried at the amount of cash for which it was acquired. The said transactions in respect thereof were not entered or recorded in any records of taxpayer as either increasing or reducing the number of the outstanding shares of its capital stock. At the

times of the acquisitions by taxpayer of certificates representing its capital stock, as set forth hereinabove, the cash of taxpayer was reduced by the amounts of cash expended for their acquisition. Likewise, at the times in 1929 when the said certificates were disposed of, the cash of taxpayer was increased by the amounts received from the disposition thereof (R. 28).

At the close of the taxable year the taxpayer had on hand 431,925 shares of its new class B common stock. As of December 31, 1929, these shares represented $19,270,690.98 out of the $19,601,594.77 total appearing on taxpayer's books in the amount designated "Investments in Non-competitive Companies". The balance of the account represented investments in the stock of two small licorice companies (from which taxpayer secured its supplies of licorice), and stock in the Glenn Tobacco Company. None of the shares of stock of the last mentioned three companies was for sale or was traded in by taxpayer (R. 28).

The profit from the sale by taxpayer of its own shares of stock arose solely through the sale of new class B common stock. The stock certificates covering the shares sold in 1929 were endorsed, surrendered, canceled, and reissued in the same normal manner as sales and purchases of all of taxpayer's shares of stock. Each transaction involved herein was a completed and closed transaction in the taxable year 1929. During 1929 each and every acqui-

sition and each and every sale made by taxpayer of its own stock was for cash and in no instance for anything except cash (R. 28–29).

Taxpayer's 1929 income tax return, schedule L, indicates a nontaxable profit of $436,581.21. It was stipulated that the last mentioned figure should be reduced by a $150,000 dividend to $286,581.21. The $436,581.21 item is reflected in taxpayer's books as a cash item. The item went into taxpayer's surplus account and was included in the financial statement of the company made to its stockholders. It was carried as a nontaxable item in accordance with taxpayer's understanding of what it was and because of Treasury Department regulations (R. 29).

In his examination and audit for the year 1929, the Commissioner did not, prior to his pleading in the Board of Tax Appeals on the taxpayer's petition to review a deficiency originally asserted on other grounds, include as taxable income or deductible loss any amount arising out of, or resulting from, the transactions hereinabove recited (R. 29).

The parties made a stipulation with respect to the deficiency originally asserted (R. 29–30). The Board of Tax Appeals ruled that taxpayer's gains from dealings in its own stock were taxable under the amended regulation, T. D. 4430, which it held valid (R. 21–40). The Circuit Court of Appeals held that the Treasury Regulations in effect during 1929 were consistent with Section 22 (a) of the Revenue Act of 1928, that they had received legis-

lative sanction through the continued reenactment of the statutory provision and were therefore controlling. It held that the gain from dealing in the taxpayer's own stock during the taxable year was not subject to tax, and reversed the decision of the Board of Tax Appeals (R. 108–116).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the gain derived by the taxpayer from dealing in its own stock under the circumstances of this case was not subject to the Federal income tax.

2. In failing to hold that the gain derived by the taxpayer from dealing in its own stock under the circumstances of this case was taxable income under Section 22 (a) of the Revenue Act of 1928 and under the Sixteenth Amendment.

3. In holding that Article 66 of Treasury Regulations 74, prior to its amendment by T. D. 4430, was consistent with Section 22 (a) of the Revenue Act of 1928.

4. In failing to hold that Article 66 of Treasury Regulations 74, prior to its amendment by T. D. 4430, was in conflict with Section 22 (a) of the Revenue Act of 1928 and was therefore invalid.

5. In holding that T. D. 4430, amending Article 66 of Treasury Regulations 74, could not properly be applied retroactively.

6. In failing to hold that Article 66 of Treasury Regulations 74, as amended by T. D. 4430, was

valid, and applicable to the facts of this case.

7. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below is in direct conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *First Chrold Corp.* v. *Commissioner*, 97 F. (2d) 22. In both the instant case and the *First Chrold Corp.* case, the taxpayers were corporations dealing in their own stock and derived a gain from the sale of their own stock during the taxable years; in both cases the taxpayers bought their own stock for cash on the open market and sold it for cash, and there was no evidence to show that either corporation intended, or was authorized by its stockholders, to make a change in its capital set-up. In both cases the question is whether the gains are taxable under the general definition of "gross income" contained in Section 22 of the Revenue Acts of 1928 and 1932, *infra*, p. 26.[1] In both cases the Treasury Regulations interpreting this section provided in part, as originally promulgated, that a corporation realizes no gain or loss from the purchase or sale of its own stock; and prior to the hearing before the Board of Tax Appeals the Treasury Regulations were amended so as to provide that where a corporation deals in its own shares as it might in the shares of

[1] The memorandum opinion of the Board of Tax Appeals discloses that the *First Chrold Corp.* case involved the taxable year 1932.

another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. T. D. 4430, *infra*, p. 27. In the instant case the Board of Tax Appeals held that the rule to be applied was that contained in the amended regulation and that, considering the magnitude and extent of the corporation's operations during the taxable year, its gains from dealings in its own stock constituted income under T. D. 4430 (R. 30, 34–40). In the *First Chrold Corp.* case, the Board held simply that its decision in the *R. J. Reynolds Tobacco Co.* case was controlling. See Prentice-Hall 1938 Federal Tax Service, vol. 1, par. 4.27.

In these cases, similarly treated in the Board, the Circuit Courts of Appeals reached conflicting results. In the instant case the court below refused to consider the correctness *vel non* of the rule set out in the amended regulation, or whether the Board had properly applied that regulation in the circumstances of this case,[2] but held that the amended regulation could not be applied at all because the regulation existing prior to the amendment was valid and had received legislative sanction. In the *First Chrold Corp.* case,[3] the Circuit

[2] Because the court below did not rule on this question we are not giving it separate, extended consideration in this petition. If certiorari is granted, and respondent denies the applicability of the amended regulation, we shall argue the question more fully in the brief on the merits.

[3] The taxpayer filed a petition for rehearing in that case based on the decision of the court below in the instant case and the petition was denied on June 28, 1938; a supple-

Court of Appeals did consider the rule embodied in the amended regulation, approved that rule on the merits, and held that it had been properly applied to the circumstances of the case.

The diversity of opinion in the Circuit Courts of Appeals is intensified by the opinion of the Circuit Court of Appeals for the Second Circuit in *E. R. Squibb & Sons* v. *Helvering,* Prentice-Hall 1938 Federal Tax Service, par. 5.544, decided July 11, 1938. In that case the court also refused to apply the amended regulation and held that the regulation as originally promulgated had been confirmed through the acquiescence of Congress. The court stated: "We agree rather with *Reynolds* v. *Com'r,* 97 F. (2d) 302 (C. C. A. 4), than with *First Chrold Corp.* v. *Com'r,* 97 F. (2d) 22 (C. C. A. 3)." It may also be noted that the Court of Appeals for the Second Circuit injected another factor into the situation by holding that the corporation did realize gain to the extent that the sale price exceeded the value of the shares at the time of sale (as contrasted with the ordinary basis, e. g. cost price, used in the amended regulation), and remanded to the Board to assess a deficiency upon that basis.[4]

2. The decision below is erroneous. It approves an interpretation of the Revenue Act exempting

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mental petition for rehearing was filed in July 1938, based on the decision of the Circuit Court of Appeals for the Second Circuit in *E. R. Squibb & Sons* v. *Helvering*, *infra*. The court has not yet acted on this petition.

[4] The taxpayer has filed a petition for rehearing, which has not yet been acted upon.

taxpayers' gain from taxation. Section 22 (a) of the Revenue Act of 1928, *infra*, p. 26, provides in part that "gross income" includes gains, profits, and income derived from sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. None of the transactions in question are cases of the original issue of stock,[*] and there is no evidence in the record to show that the corporation intended, when it bought the stock, to reduce its capital, or, when it sold the stock, to increase its capital. The taxpayer simply went out on the open market and bought its own stock for cash, and afterwards sold the same stock for a greater amount of cash. From a practical point of view, the taxpayer has clearly derived a gain from the sale of personal property resulting from such transactions, within the meaning of Section 22 (a), and this Court has said that taxation is eminently practical. *Tyler* v. *United States*, 281 U. S. 497, 503.

That gain derived by a corporation from trading in its own stock under circumstances similar to those in the instant case constitutes income is con-

[*] Article 66 of Treasury Regulations 74, as amended by T. D. 4430, expressly provides that the receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

vincingly explained by the Circuit Court of Appeals for the Third Circuit in *First Chrold Corp.* v. *Commissioner,* 97 F. (2d) 22. That court approved the distinction taken by the amended regulations between different types of dealing by a corporation in its own stock, and continued (pp. 22–23):

> It is not easy to get in theory the concept of a corporation owning a share of itself and is perhaps not possible. Corporate shares are however easily thought of as property which may be bought and sold as are other kinds of property. A corporation may in a practical sense so deal in its own stock. When it does, the fact that it is its own stock, is ignored. We know this because corporations do so deal in their own stocks by buying and selling as they buy and sell other property, and this corporation did that very thing here. We are unable to accept the proposition that what it did in fact may be by the use of mental gymnastics turned into the theory that it was not buying and selling its stock as property but when it purchased was reducing the total sum of its capital stock and when it sold expanding its capital. A fairly good test of whether a gain is an income gain or a capital gain is whether it is distributable in dividends payable out of profits. This corporation bought shares of its stock at a price and sold it at a higher price. It in fact had taken in more than it had paid out and had the gain in hand. This was, considered of itself, properly distributable in dividends payable out of profits.

A cognate question considered by the Circuit Courts of Appeals has resulted in several rulings, with which the decision below seems to be inconsistent, that gain may be realized by a corporation exchanging property rights for its own stock, that such stock may constitute an asset in its hands, and that accounting theory looking to the contrary result may not be pressed "too far in disregard of plain facts." *Commissioner* v. *S. A. Woods Mach. Co.*, 57 F. (2d) 635 (C. C. A. 1st), certiorari denied, 287 U. S. 613; *Dorsey Co.* v. *Commissioner*, 76 F. (2d) 339 (C. C. A. 5th), certiorari denied, 296 U. S. 589; *Allyne-Zerk Co.* v. *Commissioner*, 83 F. (2d) 525 (C. C. A. 6th).

The court below did not consider on the merits the question whether a corporation may realize income from dealings in its own stock, but merely suggested that neither answer was without a reasonable basis, and applied the rule that reenactment of a statute after an interpretative ruling "amounts to a legislative sanction of the course pursued" (R. 115).

The court's fundamental error consisted in applying this doctrine without consideration of its exceptions,[6] and without recognition of the factor that a regulation seeking to determine what is

[6] It is not controlling when the regulation is unclear. *Commercial Credit Co.* v. *Tait*, 2 F. (2d) 862 (D. Md.), aff'd on the opinion below, 7 F. (2d) 1022 (C. C. A. 4th). See discussion in *Dorsey Co.* v. *Commissioner*, 76 F. (2d) at 340, *supra*, of the purview of Art. 66 of Regulations 74, as originally promulgated.

income may involve very different considerations from a regulation promulgated under specific authority given in some section, or a regulation determining the proper classification or basis of an item of income or deduction, etc. It is settled that the reenactment doctrine does not apply where the statute itself is unambiguous (*Biddle* v. *Commissioner,* 302 U. S. 573, 582), or where the regulation allegedly confirmed creates a rule "out of harmony with the statute" and is therefore a nullity. *Manhattan Co.* v. *Commissioner,* 297 U. S. 129, 134–135. These qualifying rules operate with full force where the question turns, as this case does, on the coverage of the general definition of "gross income" reenacted in the several Revenue Acts. This Court has frequently pointed out that in this general definition Congress "intended to use its power to the full extent." *Irwin* v. *Gavit,* 268 U. S. 161, 166; *Helvering* v. *Stockholms &c. Bank,* 293 U. S. 84, 89; *Douglas* v. *Willcuts,* 296 U. S. 1, 9; *United States* v. *Safety Car Heating Co.,* 297 U. S. 88, 93; *Guaranty Trust Co.* v. *Commissioner,* 303 U. S. 493, 500. The statute and the intent of Congress are plain enough, and leave no discretion to the Treasury Department, though the determination as to what constitutes income may be a difficult one. The court's conclusion that both regulations constitute reasonable interpretations of the statute is apparently based on the difference of opinion among accounting authorities, many of which are cited in footnotes to the opinion of the

court below (R. 112, 113).[7] But this state of expert opinion does not enlarge the power of the Commissioner or permit him to exempt the income from tax if in truth gain derived from trading in a corporation's own stock may be income under the statute.

Congress did not intend, by its reenactment of Section 22, to commit itself to the theories of income promulgated by the Commissioner. In *Helvering* v. *Powers,* 293 U. S. 214, this Court said, concerning Treasury Regulations intended to interpret the constitutional doctrine of State immunity from Federal taxation (p. 224):

> But the Treasury Department could not by its regulation either limit the provisions of the statute or define the boundaries of their constitutional application.

The statute may not be delimited by the Treasury Department's opinions concerning the nature of income any more than by its view as to the proper scope of the immunity doctrine. Thus this Court has recently characterized as inconsistent with the Revenue Acts, and therefore of no effect despite subsequent reenactment of the pertinent sections, regulations determining the basis of stock received by way of dividend which were "based upon the erroneous premise that stock dividends could not be income," *Helvering* v. *Gowran,* 302 U. S. 238, 244, note; *Koshland* v. *Helvering,* 298 U. S. 441,

[7] See also Journal of Accountancy, 1938, June and July issues.

447. And this rule has its counterpart, perhaps buttressed by constitutional considerations, where the court feels that the regulation attempts to expand the income taxed by Congress. *Hewitt Realty Co.* v. *Commissioner,* 76 F. (2d) 880 (C. C. A. 2d), where the court said (p. 884):

> * * * this is not merely a question of the meaning of a statute, but of what can normally be taxed under the Sixteenth Amendment, and the re-enactment of the income tax law has little or no effect upon that.

Moreover, even under the view of the court below, that either of the Regulations can be deemed reasonable, its conclusion that the second cannot be applied retrospectively does not necessarily follow. Reenactment of a section under which a regulation has been promulgated "is persuasive evidence of legislative approval of the regulation," *Brewster* v. *Gage,* 280 U. S. 327, 337. But approval of the propriety of a regulation, as one promulgated consistently with the general authority of the Commissioner to prescribe all needful rules for the enforcement of the Revenue Act,[8] does not indicate an intention to tie the hands of the Commissioner in working out optimum administration of the statute, nor does it constitute an *ipso facto* rejection of any other regulation consistent with the statute determined by the Commissioner to effect a preferable implementation of the legislation.

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[8] Sec. 62 of the Revenue Act of 1928, c. 852, 45 Stat. 791, reenacted in the subsequent Revenue Acts. See also Rev. Stat., Sec. 161.

Morrissey v. *Commissioner*, 296 U. S. 344, 355; *Titsworth v. Commissioner*, 73 F. (2d) 385 (C. C. A. 3d). The permissibility of giving such amending regulation retrospective application to the date of enactment of the statute cannot be doubted (*Titsworth* v. *Commissioner, supra*), and, indeed, finds recognition—particularly where, as here, the amendment is occasioned by a court decision [9] (see *Morrissey* v. *Commissioner, supra*, 355), in the evolution of specific legislation authorizing the Commissioner to apply an amending regulation without retroactive effect.[10]

3. The Bureau of Internal Revenue advises that the same question is involved in six other cases, involving approximately $220,000, now pending before the Board of Tax Appeals, and in at least eighteen cases, involving more than $1,500,000, pending in the Bureau.

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[9] *Commissioner* v. *S. A. Woods Machine Co.*, 57 F. (2d) 635; see opinion below, R. 114.

[10] Sec. 1314 of the Revenue Act of 1921, c. 136, 42 Stat. 227, provided that in case of a reversal of a regulation not immediately occasioned or required by a decision of a court of competent jurisdiction, the subsequent regulation might be applied without retroactive effect. This provision was continued (Sec. 1008 (a) of the Revenue Act of 1924, c. 234, 43 Stat. 253; Sec. 1108 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 9), until 1928 when the Congress authorized the application, without retrospective effect, of any regulation or Treasury decision amending another regulation or Treasury decision. Sec. 605 of the Revenue Act of 1928, c. 852, 45 Stat. 791, *infra*, p. 26.

CONCLUSION

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Fourth Circuit should be granted.

ROBERT H. JACKSON,
Solicitor General.

SEPTEMBER 1938.

APPENDIX

Statute and Other Authorities Involved

Revenue Act of 1928, c. 852, 45 Stat. 791:

> Sec. 22. Gross Income.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

This provision was reenacted in Section 22 (a) of the Revenue Act of 1932, c. 209, 47 Stat. 169.

> Sec. 605. Retroactive regulations.
>
> Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:
>
> "Sec. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect." (U. S. C., Title 26, Sec. 1691.)

Treasury Regulations 74, relating to the Revenue Act of 1928:

ART. 66. *Sale by corporation of its capital stock.*—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizs no gain or loss from the purchase or sale of its own stock. (See article 176.)

The identical article is contained in Treasury Regulations 77, relating to the Revenue Act of 1932.

Treasury Decision 4430, approved May 2, 1934, XIII–1 Cumulative Bulletin 36:

ARTICLE 66: Sale by corporation of its capital stock. XIII–20–6792
T. D. 4430

(Also Section 23 (i), Article 176.)

INCOME TAX

Acquisition or disposition by a corporation of its own capital stock.

Articles 543 and 563, Regulations 65 and 69, and articles 66 and 176, Regulations 74 and 77, amended.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Articles 543 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, and articles 66 of Regulations 74, approved February 15, 1929, and Regulations 77, approved February 10, 1933, are hereby amended to read as follows:

Acquisition or disposition by a corporation of its own capital stock.—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from

such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

Articles 563 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, are hereby amended by striking out the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentences of those articles, and by adding the following sentence to those articles:

As to the acquisition or disposition by a corporation of its own capital stock, see article 543.

Article 176 of Regulations 74, approved February 15, 1929, is hereby amended by omitting the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentence of this article, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

Article 176 of Regulations 77, approved February 10, 1933, is hereby amended by omitting the first and second sentences thereof, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved May 2, 1934.

H. MORGENTHAU, Jr.,
Secretary of the Treasury.

U. S. GOVERNMENT PRINTING OFFICE: 1934